

Message Text

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ACTION EA-12

INFO OCT-01 EUR-12 ISO-00 AID-05 CIAE-00 COME-00 EB-08
FRB-01 INR-10 NSAE-00 ICA-20 XMB-04 OPIC-06 SP-02
LAB-04 SIL-01 OMB-01 L-03 H-02 NSC-05 SS-15
STR-07 CEA-01 PA-02 DOE-15 SOE-02 OES-09 DOEE-00
/148 W

-----060475 261026Z /17

P 260940Z JUL 78

FM AMEMBASSY TOKYO

TO SECSTATE WASHDC PRIORITY 9897

TREASURY/DEP WASHDC PRIORITY

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY ROME

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USEEC

USOECN ALSO FOR EMBASSY

E.O. 11652: N/A

TAGS: EFIN, JA

SUBJECT: FINANCIAL AND ECONOMIC DEVELOPMENTS -- JULY
20-26

1. SUMMARY: YEN BREAK-THROUGH TO 200 AND MOVE ON TO
194.50 DOMINATES HEADLINES. MOST REACTION MEASURED, BUT
NEW CALLS ISSUED FOR STRONG, EARLY FISCAL MEASURES. MOF
OFFICIALS REPORTEDLY PONDERING PROPOSALS TO MAKE TO U.S.
FOR DOLLAR STABILIZATION. GOVT BOND SALES MEET MARKET
RESISTANCE. FOREIGN DOLLAR BOND SALES TO BE PERMITTED
AGAIN. BOJ TO PROVIDE CREDIT TO CALL MONEY BROKERS TO
HELP SMOOTH MARKET. RETAIL SALES STRONG IN JUNE AND IN
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SECOND QUARTER. BOTH YEN EXPORT AND IMPORT PRICES DROP
IN JUNE. WEAK PRIVATE CREDIT DEMAND ACCOUNTS FOR SLOW
MONEY GROWTH IN MAY. END SUMMARY.

2. ON MONDAY JULY 24 THE YEN ROSE ABOVE THE 200 LEVEL IN
THE TOKYO INTERBANK MARKET FOR THE FIRST TIME IN THE POST-
WAR ERA. THE MOVE BEYOND 200 OCCURRED DESPITE A VISIBLE

BUT BRIEF ATTEMPT BY THE BANK OF JAPAN (BOJ) TO BRAKE THE APPRECIATION. TRADING IN THE INTERBANK SPOT MARKET WAS EXTREMELY HEAVY AT \$900 MIL, WITH BOJ INTERVENTION FOR THE DAY PLACED AT \$500 MIL, THE BULK OF WHICH WAS REPORTEDLY EXPENDED IN THE EARLY MINUTES OF TRADING WHEN THE MARKET OPENED CLOSE TO 200. IN THE FACE OF PERSISTENT DEMAND FOR YEN, THE BOJ REPORTEDLY WITHDREW QUICKLY AND CONFINED ITS SUBSEQUENT DOLLAR PURCHASES DURING THE UNCLASSIFIED

DAY TO RELATIVELY SMALL AMOUNTS. THE STRONG DEMAND FOR YEN CARRIED OVER TO TUES, JULY 25, AND WITH THE BOJ OFFERING ONLY NOMINAL RESISTANCE IN THE FACE OF VERY HEAVY VOLUME, THE YEN TOUCHED A HIGH OF 195.30. PRESS REPORTS ALTERNATELY PUT BOJ INTERVENTION AT \$50 MIL OR \$200 MIL FOR THE DAY, WITH TOTAL SPOT VOLUME RUNNING TO \$819 MIL. IN MORE STABLE TRADING THE YEN MOVED IN THE 195-196 RANGE ON WED MORNING JULY 26 BUT ROSE TO 194.50 LATE IN THE DAY. MARKET COMMENTATORS ATTRIBUTED REPORTS THAT OPEC WAS CONSIDERING A MOVE AWAY FROM DOLLAR PRICING OF OIL AS THE TRIGGERING EVENT FOR THE LATEST YEN SURGE.

3. REACTION TO THE YEN'S MOVE ABOVE 200 WAS MEASURED, BUT A NOTE OF FOREBODING CAN BE DETECTED IN SOME COMMENTARIES. EDITORIALISTS AND INDUSTRY SPOKESMEN REPLAYED THE NOW UNCLASSIFIED

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FAMILIAR LIST OF BENEFITS AND COSTS OF THE APPRECIATING YEN, WITH MANY REMARKING THAT EXPORTERS HAVE TO DATE ADJUSTED BETTER THAN EXPECTED TO THE HIGH YEN AND WOULD CONTINUE TO SOLDIER ON. HOWEVER, AN UNDERCURRENT OF CONCERN THAT THE PROGRESSIVE APPRECIATION MUST INEVITABLY HAVE A CUMULATIVELY DEPRESSING EFFECT ON EXPORT INDUSTRIES WAS EVIDENT. FOR EXAMPLE, CHAIRMAN DOKO OF KEIDANREN MET WITH PRIME MINISTER ON TUES JULY 25 AND REPORTEDLY CALLED ON THE PRIMIN TO ADOPT A STIMULUS PACKAGE PRODUCING ADDITIONAL DEMAND OF YEN 3 TRILLION TO ASSURE CONTINUED ECONOMIC RECOVERY. DOKO NOTED IN PARTICULAR THAT THE YEN APPRECIATION WAS LIKELY TO HAVE AN ACUTE IMPACT ON EXPORT VOLUME CREATING STRONG DEFLATIONARY EFFECTS. GOVT OFFICIALS WERE ALSO LED BY THE LATEST YEN APPRECIATION TO COMMENT ON THE NEED FOR SUPPLEMENTARY FISCAL MEASURES. FINANCE MINISTER MURAYAMA IN A SPEECH ON JULY 24 SAID IT MIGHT BE POSSIBLE TO DRAW ON BUDGETED RESERVES AND ADDITIONAL FISCAL LOAN AND INVESTMENT FUND PROGRAM (FLIP) RESOURCES TO FINANCE ADDITIONAL SPENDING

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TO SECSTATE WASHDC PRIORITY 9898

TREASURY/DEP WASHDC PRIORITY

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C O R R E C T E D C O P Y TEXT (DELETE FIRST PARAGRAPH (13 LINES)
FROM "POW'S DIED THROUGH LIMITED
OFFICIAL USE")

OF ABOUT 1 TRIL YEN. THE NEXT DAY, MITI MINISTER KOMOTO
REPORTEDLY TOLD THE PRESS ANY SUPPLEMENTARY MEASURES
SHOULD SUBSTANTIALLY EXCEED THE YEN 1 TRIL FIGURE SUG-
GESTED BY THE FINANCE MINISTER. NAGANO, THE PRESIDENT OF
THE JAPAN CHAMBER OF COMMERCE, ALSO PROPOSED A YEN 2 TRIL
INCOME TAX CUT BECAUSE OF CONCERN ABOUT THE EFFECTS OF YEN
APPRECIATION.

4. SEVERAL GOVT OFFICIALS WERE QUOTED AS SAYING THERE
WAS A WIDESPREAD FEELING THE YEN WAS OVERVALUED AND THE
CURRENT RATES MAY PROVE TEMPORARY. IN MORE POINTED COM-
MENTS, UNNAMED OFFICIALS AT THE FINANCE MINISTRY WERE
CITED AS SAYING THAT THE MOF WOULD SUPPORT ALMOST ANY PLAN
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TO HELP STABILIZE THE DOLLAR. THE SOURCE SAID THE MOF
BELIEVED THE BONN SUMMIT HAD MADE VIRTUQPLX NO PROGREYF

IN STABILIZING THE DOLLAR AND THAT IT WAS NOW EXAMINING CONCRETE MEASURES SUCH AS ASKING THE U.S. TO FLOAT FOREIGN CURRENCY BONDS TO ABSORB EXCESS DOLLARS, PUSHING THE U.S. TO ACHIEVE THE CUT IN OIL IMPORTS PROMISED AT THE SUMMIT, AND, AS A LONG-TERM MEASURE, INTRODUCTION OF A TARGET ZONE EXCHANGE RATE SYSTEM. THE OFFICIAL DID, HOWEVER, EXPRESS RESERVATIONS ABOUT THE TECHNICAL FEASIBILITY OF SDR SUBSTITUTION ACCOUNT PROPOSALS SUGGESTED AT THE LAST IMF INTERIM COMMITTEE MEETINGS.

5. ACCORDING TO PRESS ACCOUNTS OF RECENT DAYS, SECURITIES HOUSES HAVE RECENTLY EXPERIENCED SLOW SALES OF GOVT BONDS, CAUSING SOME CONCERN AT THE MOF ABOUT HOW SMOOTHLY THE GOVT WILL BE ABLE TO FINANCE ITS LARGE BUDGET DEFICIT. THE SECURITIES FIRMS, WHICH HAVE TAKEN UP ABOUT ONE-QUARTER OF RECENT TEN-YEAR BOND ISSUES FOR RESALE TO THE PUBLIC, ARE REPORTED STILL TO BE HOLDING A SUBSTANTIAL AMOUNT OF THEIR SHARE OF THE RECENT ISSUES. MARKET PARTICIPANTS REPORTEDLY BELIEVE INTEREST RATES HAVE REACHED A TROUGH AND ARE RELUCTANT TO MAKE NEW LONG-TERM COMMITMENTS AT PRESENT BOND PRICES. SOME REPORTS INDICATE MOF IS CONSIDERING EXPANDING THE ISSUANCE OF THE RECENTLY INTRODUCED THREE-YEAR BONDS BUT IS CONCERNED ABOUT THE LONGER-TERM DEBT MANAGEMENT PROBLEMS IT FACES.

6. MOF INTENDS TO PERMIT FOREIGN BOND ISSUES DENOMINATED IN DOLLARS ON JAPANESE CAPITAL MARKET, NIHON KEIZAI REPORTED JULY 21. THIS ACTION IS CONSIDERED AS A COUNTER-MEASURE TO THE SLOWDOWN OF FOREIGN YEN BOND ISSUES IN RECENT MONTHS THAT HAS BEEN ATTRIBUTED TO UNCERTAINTY ABOUT YEN/DOLLAR RATE MOVEMENTS AND RISING INTEREST

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RATES. FOREIGN INSTITUTIONS ISSUED DOLLAR BONDS ON JAPANESE CAPITAL MARKET IN 1972 AND 1973, BUT SINCE 1974 THEY HAVE BEEN RESTRICTED TO PRIVATE PLACEMENTS. ACCORDING TO THE PRESS ACCOUNTS, EUROPEAN INVESTMENT BANK (EIB) PLANS TO ISSUE DOLLAR BONDS AMOUNTING TO \$80 MIL ON TOKYO CAPITAL MARKET AND SIMULTANEOUSLY \$20 MIL ON EURO-MARKET AROUND END OF SEP. COUPON RATE ON EIB BOND IS ESTIMATED AT AROUND 9 PCT PER ANNUM, COMPARED TO AROUND 6.5 PCT CURRENTLY ON COMPARABLE YEN BONDS. NEVERTHELESS, EIB AND OTHER FOREIGN INSTITUTIONS ARE REPORTED TO PREFER DOLLAR BONDS TO YEN BONDS TO AVOID YEN EXCHANGE RISKS. FOREIGN DOLLAR BONDS ARE LIKELY TO BE PURCHASED PRIMARILY BY INSTITUTIONAL INVESTORS SINCE MOF REPORTEDLY WILL ASK SECURITIES FIRMS NOT TO SOLICIT THE GENERAL PUBLIC FOR THE OFFERS. MOF IS ALSO ASKING BANKS TO BUY, RATHER THAN BORROW, THE REQUIRED DOLLARS TO HELP REDUCE UPWARD PRESSURES ON YEN ON TOKYO FOREX MARKET.

7. BOJ HAS RESUMED EXTENDING CREDITS TO SHORT-TERM MONEY BROKERS, WHO HAVE RECENTLY RECEIVED BOJ CREDITS AMOUNTING TO YEN 80 BIL. SUCH CREDIT EXTENSION HAD BEEN SUSPENDED SINCE AUG 1967 BUT THE BOJ DECIDED TO RESUME IT TO SMOOTH OUT ERRATIC MOVEMENTS OF CALL MONEY RATES FOLLOWING THE RECENT LIBERALIZATION OF THE CALL MARKET. CALL MONEY BROKERS HAVE BEEN ACTING NOT ONLY AS MIDDLEMEN BUT HAVE ALSO TAKEN POSITIONS FROM TIME TO TIME, BUT SUCH ACTION HAS BEEN LIMITED TO FILLING GAPS BETWEEN SUPPLY AND DEMAND ON OCCASION. IN CASE OF BILL DISCOUNTS, SHORT-TERM MONEY BROKERS ARE RESTRICTED TO ACTING AS MIDDLEMEN

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TRYING TO MATCH SELLERS AND BUYERS OF THE BILLS.

8. RETAIL SALES REBOUNDED IN JUNE AND FOR APRIL-JUNE QUARTER RECORDED A STRONG INCREASE. ACCORDING TO DATA RELEASED BY MINISTRY OF INTERNATIONAL TRADE AND INDUSTRY (MITI), DEPARTMENT STORE SALES, S.A., ROSE 1.2 PCT IN JUNE OVER THE PRIOR MONTH'S LEVEL AFTER THE 0.5 PCT DETERIORATION IN MAY. FOR THE APRIL-JUNE QUARTER AS A WHOLE, DEPARTMENT STORE SALES RECORDED A 2.3 PCT INCREASE (S.A.) ON TOP OF THE 3.1 PCT GAIN IN THE FIRST

QUARTER. YEAR-OVER-YEAR INCREASES IN SALES OF DEPARTMENT STORES AND SUPERMARKETS BOTH ACCELERATED IN THE SECOND QUARTER.

TABLE 1: DEPARTMENT STORE SALES (S.A.; 1975 EQUALS 100; PCT CHANGE FROM PRIOR PERIOD IN PAREN):

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RECENT MONTHS: RECENT QUARTERS:

APRIL	122.6 (0.7)	1977:OCT-DEC	116.4 (-0.1)
MAY	122.0 (-0.5)	1978:JAN-MAR	120.0 (3.1)
JUNE	123.5 (1.2)	APR-JUNE	122.7 (2.3)

TABLE 2: SALES OF DEPARTMENT STORES AND LARGE-SCALE SELF-SERVICE STORES, N.S.A. (IN BIL YEN; PCT CHANGE FROM YEAR EARLIER IN PAREN):

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- DEPARTMENT STORES SELF-SERVICE
- STORES

RECENT MONTHS:

APRIL	419.1 (7.3)	387.9 (17.6)
MAY	402.2 (6.6)	374.5 (12.7)
-	(REV)	
JUNE	415.2 (8.6)	387.0 (17.6)

RECENT QUARTERS:

1977:OCT-DEC	557.1 (5.1)	415.0 (16.1)
1978:JAN-MAR	390.9 (6.1)	343.5 (14.5)
- APRIL-JUNE	412.2 (7.5)	383.1 (16.0)

9. IMPORT CONTRACT PRICE INDEX (N.S.A.; DENOMINATED IN YEN) DECLINED MORE RAPIDLY THAN EXPORT PRICES IN JUNE. ACCORDING TO BANK OF JAPAN, IMPORT CONTRACT PRICE INDEX FELL 3.3 PCT IN JUNE FROM THE PRIOR MONTH'S LEVEL (N.S.A) AFTER THE 1.3 PCT INCREASE IN MAY WHILE EXPORT PRICE INDEX DECLINED 1.5 PCT AFTER A 1.8 PCT GAIN. DURING

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FIRST SIX MONTHS OF THIS YEAR EXPORT PRICE INDEX REMAINED VIRTUALLY UNCHANGED (DOWN 0.6 PCT FROM DEC 77 TO

JUNE 78) WHILE IMPORT PRICE INDEX DECLINED APPROXIMATELY
7 PCT DURING THE SAME PERIOD.

EXPORT AND IMPORT CONTRACT PRICE INDICES, N.S.A. (1975
EQUALS 100; PCT CHANGE FROM PRIOR MONTH IN PAREN)

- EXPORTS (JEI 80) IMPORTS (JEI 88)

APRIL	89.0 (-1.0)	87.4 (-3.9)
MAY	90.6 (1.8)	88.5 (1.3)
JUNE	89.2 (-1.5)	85.6 (-3.3)

10. FOLLOWING TABLE JUST RELEASED BY BOJ SHOWS FACTORS
CONTRIBUTING TO MAY CHANGE IN M-2, N.S.A. CREDIT TO
NATIONAL AND LOCAL GOVTS INCREASED IN MAY, BUT WERE MORE
THAN OFFSET BY DECLINE IN CREDIT TO PRIVATE SECTOR.

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CHANGE IN M-2 (MONTHLY PCT CHANGE AT ANNUAL RATE, I.E.
TIMES 12):

-	MAR	APR	MAY
M-2, S.A.	12.0	26.5	2.4
M-2, N.S.A.	21.2	29.3	- 0.1

(FACTORS CONTRIBUTING TO CHANGES IN M-2, N.S.A.):

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CREDITS TO:

PRIVATE SECTOR	13.7	1.9	- 0.7
NATIONAL GOVT	12.0	15.5	0.8
LOCAL GOVTS	3.8	2.2	0.4
FOREIGN ASSETS,NET	6.6	0.4	0
OTHERS	-14.9	9.3	- 0.6
TOTAL ALL FACTORS	21.2	29.3	- 0.1

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Message Attributes

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